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Financial Markets

Irving Trust

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Economic Research &
Planning Division

Friday
(Noon)

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The dust of the past several weeks has begun to settle. Quarter-end has passed us by. We are through with the last CRA period that saw banks settle their reserve accounts with the Fed early Tuesday because of the Wednesday holiday. Market participants have recovered from their initial reactions to the flash GNP figures and the first-quarter GNP revision. And, as we look for what remains after these special factors are swept aside, we find Fed funds trading firmly at and above 11%, essentially confirming that the Fed has tightened its belt another notch.

At this point a dilemma is suggested: 1) How much higher must rates be raised to slow the economy? 2) How can other nations withstand further U.S. interest rate increases? In this letter we have previously discussed the first question. The response to this question is that it takes very high rates for a long time. The lags involved are not well known. The critical rate levels remain a mystery and therefore a matter of judgment, for economists, for the Fed. The answer to the second question has become more interesting recently.

It is well understood that many LDCs have a debt problem. Therefore it is realized that deflationary policies hurt the LDCs. A tight monetary policy is deflationary. It restrains growth, raises interest rates, suppresses inflation, and in so doing it keeps in check commodities prices. Commodities are the primary exports of many LDCs. The Fed has hoped that growth in the U.S. would be sufficient to aid the LDCs--even if monetary policy remained restrictive. Right now this point of view is being tested. Here again there are no magic numbers, no critical rate levels, no barrier that "can't" be surpassed, but there is danger at each uptick of rates. Is this policy well conceived?

This question will be answered only by history. For now some of the risks can be spelled out. High interest rates impact U.S. residents on an after-tax basis due to the deductibility of interest rates. But interest rates bite abroad on a before-tax basis. (Indeed, this point applies to the U.S. Treasury itself as its interest expenses on the public debt are definitely not "deductible"!) In addition these high rates complicate policy-making in the highly developed and industrialized countries abroad. Previously the sophisticated internationalist scoffed at the prospect that this would lead the U.S. to alter its policy. U.S. monetary policy might create "problems" for West Germany or other EMS member countries but these were their problems--not a real reason for the U.S. to swerve its policy course.

Things differ now. The LDCs have real problems that intimately involve the U.S.: its banks, its exporters and its consumers. Our mutual dependence on nations abroad, both developed and developing, has increased. The U.S. international cold shoulder must warm. But when and how this happens remains an elusive matter. Until (or unless) a long-term "solution" to LDC debt problems is found, rises in U.S. interest rates are hard to conceive. This doesn't mean that they can't happen, but that much is at risk if interest rates in the U.S. do rise.

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Market Yields

	7/6/84 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	13.00%	13.00%	10.50%
Effective since	6/25/84		2/28/83
Discount Rate at Federal Reserve Bank	9.00	9.00	8.50
Federal Funds	11.00	11.25	9.00
Repurchase Agreements	10.50	10.00	8.88
U.S. Treasury Issues			
Bills			
3 months	10.41	10.34	9.39
6 months	11.17	11.23	9.84
1 year	12.10	12.70	10.19
Coupons			
2 years	13.12	13.18	10.61
4 years	13.56	13.65	10.97
7 years	13.79	13.79	11.25
10 years	13.82	13.82	11.24
Long Bond	13.63	13.62	11.29
Negotiable Certificates of Deposit-Secondary Market			
1 month	11.40	11.40	9.30
3 months	11.75	11.75	9.50
6 months	12.25	12.15	9.90
1 year	13.15	13.00	10.20
Banker's Acceptances			
1 month	11.51	11.46	9.30
3 months	11.90	11.95	9.55
6 months	12.49	12.35	9.85
Eurodollar Deposits			
1 month	11.81	11.88	9.75
2 months	12.06	12.00	9.88
3 months	12.31	12.25	10.00
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	11.18	11.18	9.27
1 month	11.41	11.39	9.33
3 months	11.31	11.31	9.47
Bank Holding Companies			
1 month	11.00	10.89	9.07
Dealer Placed:			
3 months	11.68	11.68	9.57
New AA Corporate Utility Bond	14.85	14.88	12.30
Tax Exempt			
6 month Project Notes	5.80	5.75	4.60
1 year AAA Bond	6.60	6.50	5.50
5 year AAA Bond	8.10	8.00	6.45
20 year AAA Bond	10.20	10.20	9.30

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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